

Message Text

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ACTION EUR-12

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INFO AMEMBASSY BONN

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USMISSION EC BRUSSELS

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

AMEMBASSY HELSINKI

AMEMBASSY OSLO

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TAGS: EGEN, DA

SUBJECT: ECONOMIC CONSEQUENCES OF POLITICAL COMPROMISE

REF: COPENHAGEN 2750

SUMMARY: THE IMMEDIATE EFFECT OF NEW TAX AND RELATED
LEGISLATION ADOPTED AUGUST 19 (REFTEL) AND AMOUNTING TO
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ABOUT \$625 MILLION ANNUALLY WILL BE LIMITED. OVER THE

NEXT TWO YEARS, INCREASED TAXES ON PRIVATE CONSUMPTION
MAY REDUCE THE BALANCE OF PAYMENTS DEFICIT BY 25 PERCENT.
END SUMMARY.

1. THE PACKAGE OF TAX AND RELATED LEGISLATION WHICH
RESULTED FROM THE POLITICAL COMPROMISE ON AUGUST 19
(REFTEL) CONSISTS OF THE FOLLOWING MAJOR COMPONENTS:

(A) A SERIES OF TRADITIONAL TAX INCREASES, WITH
TOTAL REVENUE OF DANISH KRONER 3.8 BILLION (ABOUT \$625
MILLION) ON A 12 MONTH BASIS, INVOLVING CIGARETTES
(DKR 765 MILLION), LIQUOR (DKR 225 MILLION) WINE (DKR
135 MILLION), BEER (DKR 270 MILLION) SUGAR (DKR 300
MILLION), COFFEE (DKR 200 MILLION), TEA (DKR 10
MILLION), MOTOR VEHICLES (DKR 1,045 MILLION), GASOLINE
(DKR 800 MILLION) AND PLEASURE CRAFT (DKR 15 MILLION).
THESE TAX INCREASES ARE EXPECTED TO REDUCE PRIVATE
CONSUMPTION AND CURTAIL IMPORTS AS SOON AS THE LAST
QUARTER OF THIS YEAR. ON AN ANNUAL BASIS, IT IS
ESTIMATED THAT THE CONSUMPTION RESTRAINT MAY REDUCE
THE ESTIMATED \$1,500 MILLION FOREIGN PAYMENTS DEFICIT
SOME 25 PERCENT.

(B) NOMINAL INCOME TAX RELIEF FOR 1977 AND 1978
BY AN INCREASE OF DKR 500 (ABOUT \$80) ON EACH PER
CAPITA TAX EXEMPTION. TOTAL INCOME TAX REDUCTION
WILL PROBABLY NOT EXCEED ONE PERCENT. AT THE SAME
TIME, HOWEVER, THE APPLICATION OF A NEW MEANS TEST
FOR FAMILY ALLOWANCES WILL, FOR BREADWINNERS IN THE
ABOVE-AVERAGE INCOME GROUPS, (TAXABLE HOUSEHOLD
INCOME ABOVE DKR 110,000 (ABOUT \$17,500) FOR A FAMILY
WITH ONE CHILD) MORE THAN OFFSET THE INCOME TAX
REDUCTION.

(C) AN EXTENSION OF SUBSIDY LEGISLATION (VALUE
DKR 100 MILLION) (ABOUT \$16 MILLION FOR ENERGY-
SAVING MEASURES IN CONSTRUCTION, AND A EASING OF MORTGAGE
REGULATIONS, BOTH MEASURES ARE
DESIGNED TO MITIGATE AN EXPECTED SLACKENING OF
BUILDING ACTIVITY.

(D) A TARGET WAGE CEILING INCREASE OF
6 PERCENT FOR BOTH 1977 AND 1978. THIS CEILING
WOULD INCLUDE AUTOMATIC COL INCREASES, CONTRACTUAL
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IMPROVEMENTS UNDER NEW LABOR CONTRACTS TO BE SETTLED
IN THE SPRING OF 1977 AND, HOPEFULLY, ALSO WAGE
DRIFT. COMMENT: IT WILL BE DIFFICULT TO HOLD THE
WAGE DRIFT WHICH ACCUMULATES FROM INDIVIDUAL ADJUST-
MENTS AT PLANT LEVEL. THE DRIFT IS PRESENTLY LIMITED
BUT COULD EASILY BECOME STRONGER IF PRODUCTION
RECOVERY CONTINUES AND WORKERS AT THE SAME TIME FEEL
CHEATED BY CONTRACT LIMITATIONS. END COMMENT.

(C) A NUMBER OF PRICE AND PROFIT CONTROL MEASURES WHICH ARE AMINLY OF PSYCHOLOGICAL IMPORTANCE DESIGNED TO CONVINCE WAGE-EARNERS THAT THE WAGE RESTRAINT MEASURES MUST NOT RESULT IN UNDUE PROFIT COLLECTION.

2. COMMENT: IN GENERAL, THE PROGRAM MAY HAVE IMMEDIATE THOUGH LIMITED BENEFICIAL EFFECT ON THE BALANCE OF PAYMENTS. IT WILL HAVE LITTLE QUICK EFFECT ON EMPLOYMENT. IT MAY STRENGTHEN PRESENT TRENDS TOWARD A LOWER RATE OF INFLATION. ITS MAJOR SIGNIFICANCE MAY BE THE ACCEPTANCE OF INCOMES-POLICY PRINCIPLES WHICH, PARTICULARLY IN THE LONGER TERM, COULD HELP BY CURING SOME OF THE BASIC ILLS OF THE DANISH ECONOMY. IN THIS RESPECT, IT IS CLEARLY ONLY A FIRST STEP AND DOES NOT EXCLUDE THE POSSIBILITY THAT ADDITIONAL MEASURES MAY BECOME REQUIRED ALREADY NEXT YEAR.
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